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SUBJECT: RESPONSE: IMPACT OF RISING FOOD/AGRICULTURAL COMMODITY
PRICES -- CYPRUS

REFS: (A) STATE 39410, (B) NICOSIA 224

(U) This cable is sensitive but unclassified. Please protect accordingly.

1. (SBU) Following is our response on the impact of rising food/agricultural commodity prices in Cyprus, keyed to Ref A questions.

DEMAND: Cyprus has an open, prosperous economy and continues to enjoy an abundance of imported foods and agricultural commodities sufficient for the needs of both the local population and large tourism sector, despite rising food prices internationally. Higher food prices are painful for lower-income groups and the competitiveness of Cyprus' tourism sector. However, to keep things in perspective, these price increases will cause no more than a dent in the country's historically strong growth rates.

Cereals, which have experienced staggering price increases in recent months, are an important input of the Cypriot economy. Locally-produced grains satisfy only about 10 percent of demand -- the rest has to be imported. The Cyprus Grain Commission (CGC), which still maintains a near-monopoly in grain imports, made a good call last year when it bought large quantities of forward positions in cereals, at prices substantially below present levels (for example, it bought wheat at Euros 237 per ton back in August 2007, compared to the present prices of around Euros 280 per ton). Being a semi-government organization, the CGC refrained from pocketing the difference and passed on the benefits to consumers, thereby shielding them, to some extent, from the price increases seen elsewhere. However, the end of (relatively) cheap grain is near for Cyprus too, as those stocks will be depleted in about a month. The CGC is currently hoping for a reversal of the present rally in cereal prices. Otherwise, it will be forced, sooner or later, to pass the burden on to the public.

SUPPLY: Agriculture generates barely 3.1 percent of GDP (2007) and is steadily shrinking further. The main export crops are potatoes and oranges. There is little evidence to suggest that domestic agricultural production is responding to changes in prices, at least so far. Even the severe water shortage currently facing Cyprus has made little difference on agricultural production, as water for agriculture remains heavily subsidized. Farmers are something of a "sacred cow" in Cyprus, forming a formidable political constituency, which no administration (least of all, the present one committed to "social progress") can afford to offend. The strong Euro helps cushion, to a certain extent, higher energy prices for Cyprus and the rest of the Eurozone.

POLITICAL IMPACT: The rise in food prices has attracted a lot of press coverage in recent months and some protests by consumer organizations, although these have been kept very civilized without any hint of violence. There is no threat to the stability of the

host government or any friction between social classes over food prices. Cyprus has always been vehemently opposed to agricultural biotech, thanks to a very vocal Green party. Similarly, public sentiment towards biofuels was never positive, while the recent increases in food prices internationally only help deepen local resentment of biofuel.

ECONOMIC IMPACT: Over the last decade, Cyprus has enjoyed very low inflation, usually slightly over 2.0 percent, and only rarely exceeding 4.0 percent. In 2007, overall inflation remained low: 2.2 percent, only marginally higher than the Eurozone's 2.1 percent. Inflation rose steadily towards the latter months of 2007. Additionally, in the sub-category of Food and Non-Alcoholic Beverages, inflation rose by 5.5 percent -- fully double the overall increase. These trends have gathered steam in the first quarter of 2008. Inflation in Cyprus reached 4.7 percent by March 2008, compared with 3.5 percent in the Eurozone. Similarly, inflation in the Food and Non-Alcoholic Beverages sub-category rose by 7.0 percent in Q1, considerably above the overall average.

Higher inflation in recent months is putting a strain on Cyprus' Purchasing Power Parity (PPP) vis-à-vis the rest of the EU. In 2007, Cyprus' PPP reached 93.7 percent of the EU 27 average (EU 27 = 100), recording steady gains in recent years. However, this trend is expected to be reversed in 2008, with Cyprus' PPP declining to 92.8 percent of the EU 27 average by year-end. The brunt of this burden will be borne by lower-income households, which spend about 31 percent of their income on foodstuffs, compared to 10 percent for the highest-income households, and an average 15 percent for all households. So, the impact of higher food prices ranges from "considerable" to "negligible," depending on each household's income level.

ENVIRONMENTAL IMPACT: Rising food prices as such have not had any discernible environmental impact in Cyprus. Instead, Cyprus' main environmental problem, namely a severe water shortage, is attributable to a prolonged drought and poor planning (Ref B).

GOVERNMENT POLICY RESPONSE: The recently-elected left-wing (nominally, Communist) administration appears appropriately concerned about rising food prices, particularly as they affect poorer people disproportionately. The administration keeps a close watch on prices and competition domestically, fending off cartels and excessive profiteering as best as it can while adhering to free market principles. In terms of direct assistance to the population, the administration announced an Easter bonus for pensioners as soon as it got elected to help lessen the blow from rising food prices. The previous administration also fought hard, and eventually won from Brussels, a derogation leaving Value Added Tax (VAT) on foodstuffs and medicines at zero.

IMPACT ON POST PROGRAMS: Post has serious funding problems but these are generally unrelated to rising food prices.

POLICY PROPOSALS: So far, rising food prices have not been a focus of GOC policy planning. We suspect that, over time, this will become a more serious issue for Cyprus given its high reliance on imported grain, but it will take its policy lead from decisions made by the EU as a whole.

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